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Abstract of Doctoral Dissertation

External Debt, Foreign Exchange Constraint and Economic Growth in Developing Countries*

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PRESENT STUDY HAS been undertaken to investigate whether external debt really plays a significant role in the attainment of higher and sustainable rates of economic growth by relieving the foreign exchange constraint in the developing countries. To deal with all the facts of the study present thesis is divided into five chapters, a brief review of which is as follows:

Chapter 1. accounts briefly the introduction to the thesis which consists of the main purpose of the study, objectives, a brief review of existing theoretical and empirical literature, methodology, and plan of the study.

Chapter 2. analyses the developments in external debt of the developing countries during the years 1955-90. Factors on demand side and supply side underlying the growth of debt are analysed especially. It is observed that external debt of developing countries has been increased manifolds, viz. from $9.69 billion in 1955 to $1306.4 billion in 1990. Though severity varies across different countries/countries-groups because of varying levels and rates of growth of income and exports on the one hand and sources and structure of debt on the other. External debt of developing countries (non-oil) grew at annual average rate of about 14% during 1955-73 years. Both, supply side and demand side developments largely determined by economic, political and sometimes humanitarian factors might be responsible for this growth. During 1973-82 when it grew at an annual average rate of about 20 per cent both supply and demand side developments largely determined by the international events besides the economic and political factors remained important. Whereas during 1983-90 when it grew merely at an annual rate of about 6% demand and supply side forces remained unimportant because during this period creditors and borrowers (especially debt-ridden) were rarely left to independent decision but were guided by joint decisions prepared under the supervision of international authorities.

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Chapter 3. has two parts 3A & 3B. Where 3A finds out whether it is logical for developing countries to call forth such huge amounts of foreign capital. Since 'foreign exchange constraint theory' provides the logic for inviting external capital, accordingly in this chapter (3A) applicability of this theory is verified. Prolonged gap in balance of payments suggests that foreign exchange constraint exists in developing countries. Assumptions underlying the very constraint theory: insufficiency of exports and essentiality of imports in the process of economic development, are also found to be verified empirically in these countries for the period of 1960s to 1980s. Second part of the chapter 3, i.e. 3B examines the phenomenon, causes and international responses to the foreign exchange constraint followed by debt difficulties. Antithetically, if external debt is associated with no commensurate increase in debt-repay-capacity, foreign exchange constraint is said to be intensified. When payment charges are accumulated to the level where these become unmanageable in 'Credit Constraint', as a result of reluctance of creditors in lending further, is expectantly ensued. In such a situation macro-economy especially investment and income is adversely effected through pressures on balance of payments. Anyhow debt-difficulties by creating finance shrinkage intensify the foreign exchange constraint on economic growth in the countries which are on the way of transformation.

Chapter 4. envisages the relationship between economic growth and net transfers during the period 1970-89. Simple single variable linear regression model is used on time-series data. To analyse the effect on economic growth especially in the context of debt-repay-capacity three growth indicators re selected as variables to be regressed, namely, Growth rate of GDP (GDPg) growth of exports (Xg) and savings as a ratio to GDP(S/Y). Sample of 77 developing countries (net debtors) is selected and which further is grouped according to various categories to achieve the best possible disaggregation. So three independent linear regression equations are used to regress the effect of debt-flows of income-growth, savings, and export-growth for the period of 1970-89, and for two sub periods, 1970-79; 1980-89 for the various groups of developing countries. As first sub period, i.e. 1970-79 denotes a non-finance-constrained period and second sub-half, 1980-89, a finance-constrained; relationship between economic growth and debt-creating inflows in both the non-finance constrained and finance constrained situations is investigated for the net debtor developing countries. For each variable 57 equations are estimated; 19 each for each period and sub-period (as we have 19 country-growings in our study). Hypotheses to be tested are: a positive relationship exists between economic growth and net trnsfers in a non-finance constrained situation and a negative relationship in a finance-constrained one.

It is found that only 3 out of 19 cases, namely, South Asia, High Middle Income countries, Oil Exporting countries have significant positive relationship between GDP growth and net transfers during 1970-89. In other five & eleven cases a significant negative and non-significant relationship exists

respectively between these two variables during the same period. In case of S/Y none significant positive and 8 significant negative relationships exists respectively during 1970-89. In case of Xg only one significant desirable relationship exists for High Middle Income countries over the same period. During 1970-79, when non-finance-constrained situation exists for developing countries, following significant positive and negative results are found out of 19 each for each GDPg, S/Y, and Xg respectively: 2 positive and 5 negative for GDPg; 5 positive and 4 negative for S/Y; and none for Xg. One thing to be noted here that the groups having positive relationship in case of S/Y represent at least non-low-income countries and that having negative relationship represent almost low-income-countries. During 1980-89 a least number of significant results (only 8 out of total 57 for whole period and two sub periods) exist showing the insignificance of net transfers on economic growth. Only 2 groups in case of GDPg (out of 19) namely, Non-Problem countries and Open countries; 4 in case of S/Y (out of 19), East Asia and Pacific, Manufacture Exporting, Non-Problem, and Open Countries have the desirable negative significant relationship. These are the countries which might have made successful adjustment in their economies after the debt-difficulties. Only 2, one each in case of GDPg and Xg respectively have the not-desirable positively significant relationship indicating the adjustment failure in the very country groups during the same finance-constrained period.

Chapter 5. presents summary and conclusions of the study, policy implications, and suggestions for future research in this area.

In brief, no conclusive statement on the basis of our investigation can be made regarding the relationship between the net transfers on debt and economic growth in developing countries. However, it is clear that debt flows do not automatically contribute to the economic growth, it is mainly domestic efforts which make these flows to contribute to it. Not only efficient use but also the optimal level and structure of debts itself make these flows to contribute favourably to the economic growth by relieving foreign exchange constraint in developing countries.